[Bond Case Briefs]

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[Make Sure That Your Municipal Bonds Pay You For The Risk You Take.]

Over the past decades I have written about weird fixed income market events and crazy, newly issued bonds. This one doesn't take the cake but it's the icing on it.

The State of Louisiana in February 2021 issued some taxable municipals. No surprise there since many other municipalities followed them. Louisiana's specific series of revenue bonds refinances an older issue that was marketed to build Highway I-49 North and South. So far so good. Here's the zinger: the bonds are payable by abandoned and unclaimed property revenue after refunds and fees.

The Official Statement (page 31) defines "Unclaimed Property" as:

"…cash or securities-related property. Examples of cash include bank deposits, trust distributions, annuities, certificates of deposit, traveler's insurance policies, wages or other compensation for personal services, deposits or refunds owed to a subscriber by a utility, mineral royalty payments, property in an individual retirement account and contents of safe deposit boxes."

California and many other states call such assets, Escheat Property. The Escheat laws grant the right of a government to take ownership of estate assets or unclaimed property. This happens most often when someone dies with no will or heirs to claim the property.

By using unclaimed property as a source of revenue, Louisiana is relying on the rightful property owners to forego their rights to these assets. The state grabs them and uses the revenue generated to repay their bonds.

But what if a major portion of this unclaimed property gets reclaimed and must be paid back by the state to the rightful owners? In the case of the I-49 bonds there could be insufficient funds to make interest payments.

The Division of Administration recognized this potential problem. So it agreed to transfer up to $15 million for possible debt service payments should a significant part of the unclaimed property suddenly be reclaimed by the owners or heirs. However, this $15 million backstop is subject to governmental appropriation. In other words, it's not guaranteed. So bondholders could be left out in the cold.

This type of Special and Limited Obligation is not at the top of the pecking order like a General Obligation, water and sewer, or an airport revenue bond. Always ask yourself, "Am I getting paid for the risk I'm taking?"

These taxable munis backed by Unclaimed Property generate a big NO to such a question. The five-year Louisiana bonds yield 1.059%, seven years, 1.543%, and ten years, 1.879%. Compare these yields with alternative bonds such as the T-Mobile below.

Kudos to the underwriters who disclosed in the Official Statement the amount of abandoned and unclaimed property collected every year since 2011. This calculation netted out what Louisiana refunded to the rightful owners net of fees and administrative costs (of course). It left the actual amount allocated to the Unclaimed Property Fund. Analysts can then determine if the cash from this net Unclaimed Property Fund will be sufficient to service the bonded indebtedness.

The problem is that few individual investors actually read the Official Statement. So they will never know the risk they are taking and if they are being paid for that risk.

You would be far better off investing in corporate bonds where you receive quarterly earnings reports, revenue reports, and profit and loss reports, rather than hoping Louisiana's unclaimed property coffers will grow in an amount sufficient to pay you.

Take a look at corporate bonds like T-Mobile 4.75% due February 1, 2028 (CUSIP: 87264AAV7). This is a junk bond that S&P rates BB. But this wireless carrier's revenue growth and superior 5G coverage versus its rivals is doing quite well. There are cost synergies with its Sprint S 0.0% acquisition and it is not one of those walking dead zombie companies that rely on debt to keep them afloat. The aforementioned bonds yield around 2.04% to the Feb. 1, 2023 call and 3.54% to maturity in 2028.

Conclusion: Unclaimed property versus a 5G juggernaut? No contest.

Forbes

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